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No. 7820

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

NORTH RIVER INSURANCE COMPANY (a corporation),
Appellant and Cross-Appellee,

vs.

GUY H. CLARK, as Receiver of the Montborne Lumber Company (a corporation),
Appellee and Cross-Appellant

BRIEF OF CROSS-APPELLANT AND APPELLEE

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BRIEF OF CROSS-APPELLANT AND APPELLEE

This appeal is taken from a judgment of the District Court of the United States for the Western District of Washington, Northern Division, wherein the court refused to award the cross appellant and appellee a judgment of $8000.00 on account of damage by fire done to certain logging flat cars owned by the Northern Pacific Railway Company, and in the possession

of the cross-appellant's predecessor in interest at the time of the fire.

For purposes of clarity, the parties will be in this brief referred to as plaintiff and defendant, the positions they occupied in the lower court.

STATEMENT OF FACTS

The plaintiff is the receiver of the Montborne Lumber Company, a Washington corporation, having been appointed as such by order of the state court.

The lumber company conducted a series of logging operations near Montborne, Washington, and in connection therewith, operated a logging railway which connected with the main line of the Northern Pacific at Montborne, Washington. (Tr. p. 33, Par. 3)

On December 19, 1927, a contract was entered into between the Montborne Lumber Company and the Northern Pacific Railway Company (Tr. p. 39, to 41) under the terms of which the lumber company could and would use certain logging flat cars belonging to the railway company for the transportation of the lumber company's logs, and the lumber company agreed

> "to pay the Railroad for all damage which cars delivered to it by the Railroad through such connections may sustain from any cause whatever while in its possession." (Tr. p. 40)

On August 30, 1930, five flat cars belonging to the railway company and in the possession of the lumber company, were derailed and damaged on account thereof in the sum of $482.13. (Tr. p. 36, Par. 10)

On September 4, 1930, certain other flat cars belonging to the railway company, while in the possession of the lumber company, were destroyed by fire. (Tr. p. 36, Par. 11) The total damage and loss caused by both the derailment and fire was $8000.00. (Tr. p. 37, Par. 13)

On August 11, 1930, a policy of insurance was issued by the defendant to the Montborne Lumber Company. (Tr. p. 49, Par. 57) This policy insured the Montborne Lumber Company

> "against loss or damage caused by fire, derailment or collision * * * to rolling stock as per schedule." (Tr. p. 50)

In the schedule which is attached to the policy (Tr. p. 57) appears this item:

> "12 CARS OWNED by any other than the Assured, consisting principally of Northern Pacific flat cars, main line tanks, and coal gondolas, being an equal amount of coverage on each." (Tr. p. 57)

There is also attached to the policy a special endorsement, which reads as follows:

"ENDORSEMENT

It is also understood and agreed that this policy

covers the legal liability only of the assured on logging cars owned by others in the possession of the assured, but it is a warranty of this insurance that the insured shall not have at risk an average of more than twelve (12) cars at any one time.

All other terms and conditions remaining unchanged.

This slip is attached to and forms part of Policy No. 11187 of the NORTH RIVER INSURANCE COMPANY issued to MONTBORNE LUMBER COMPANY.

Seattle, Wash. AUGUST 11th, 1930.

(Marine Dept.)

AMERICAN INSURANCE AGENCY

By F. A. FREDERICK, Agent." (Tr. p. 56)

On February 26, 1931, after the appointment and qualification of the receiver of the lumber company, the defendant insurance company paid to the Northern Pacific Railway Company $8000.00 in full settlement of the railway company's claim against the lumber company on account of the damage to the cars. (Tr. p. 38, Par. 17) This settlement was made without the knowledge or consent of the receiver. Tr. p. 38, Par. 17)

Another phase of this controversy involved the claim on account of the loss of the locomotive which is the subject of an appeal by the defendant and separate briefs have been prepared and filed dealing therewith.

ASSIGNMENT OF ERRORS

The assignment of errors is as follows:

First: The court erred in denying plaintiff's motion made January 14, 1935, for the entry upon the findings of a conclusion of law that the plaintiff is entitled to judgment against the defendant in the sum of $15,000.00, together with interest from the date thereof, and with plaintiff's costs and disbursements as provided by law, and for entry of judgment for the plaintiff for said sums pursuant to such conclusion, to which denial plaintiff duly excepted and which exception was regularly allowed.

Second: The court erred in construing the insurance policy in this case as not requiring the defendant to pay to the plaintiff $8000.00, for which the plaintiff was liable to the Northern Pacific Railroad.

Third: The court erred in construing the policy of insurance in this case as an indemnity or liability policy instead of a fire insurance policy.

Fourth: The court erred in holding that the payment by the defendant to the Northern Pacific Railroad Company was an accord and satisfaction of the policy of insurance in this case.

Fifth: The court erred in holding that the parties to the insurance policy intended that the liability of the insured, rather than the loss or damage to the insured was the thing insured against.

Sixth: The court erred in holding that as to plain-

tiff's claimed recovery for damages to the logging flat cars, plaintiff had failed to sustain the burden or proof.

Seventh: The court erred in holding that the plaintiff was not legally liable to the railroad company in the sum of $8000.00.

Eighth: The court erred in holding the release and discharge of the plaintiff's predecessor in interest, evidenced by "Exhibit 2," to be an accord and satisfaction, and that the plaintiffs wholly failed to prove that as a result of the damage to the cars plaintiff was legally liable to the railroad company in the sum of $8000.00.

ARGUMENT

The cross appellant's position is this:

The policy sued upon was a policy of fire insurance and under the law of the State of Washington, the only way an insurer may relieve itself of liability on a fire insurance policy is by payment to the named assured.

POLICY WAS A FIRE INSURANCE POLICY

For a determination of this question, we are compelled to look to the policy.

32 C. J. 1095:

"The character of a particular policy is to be

determined by the nature of a contract it expresses, rather than by the nomenclature of the policy, or the character and avowed purposes of the company that issued it."

Knott vs. Security Mutual Life Insurance Co.
144 S. W. 178

CONTENTS OF POLICY

An examination of the nomenclature of the policy reveals several significant clauses which indicate not only that the policy is not a liability policy, but is a policy insuring against damage caused by certain specific causes.

The first of these portions is the opening paragraph of the policy which reads as follows:

> "In consideration of the stipulations herein named and of $630.00 premium (the company) does insure Montborne Lumber Company from the 8th day of August, 1930, at noon, Standard Time at place of insurance against direct loss or damage as hereinafter provided to an amount not exceeding TWENTY FIVE THOUSAND TWO HUNDRED DOLLARS, to Rolling Stock, as per schedule." (Tr. pp. 49, 50)

A reference to the schedule written on the reverse side of the policy (Tr. p. 57) discloses that only two pieces of equipment are insured, first, the locomotive, and second, the cars involved in this litigation. There is no intimation that the insurance upon the locomotive is a liability insurance.

The rates charged by the insurance company for the

locomotive and the flat cars are the same, to-wit, 2½%.

It is a well recognized and known fact that the rates on liability insurance and fire insurance are not identically the same.

Another section of the policy which clearly indicates that the policy is not one of liability insurance is Section 2 thereof, which reads as follows:

> "2. Perils Insured Against.
> This Policy Insures Only:
> Against loss or damage caused by fire, derailment or collision (coming together of cars and / or locomotives in shifting or coupling not to be considered a collision) collapse of bridges, lightning, cyclone, tornado and flood." (Tr. p. 50, 51)

PLAINTIFF HAS AN INSURABLE INTEREST

The relationship existing between the lumber company and the railroad company was either one of landlord and tenant, or one of bailor and bailee. That the tenant or bailee, under such a situation, has an insurable interest in the property, is established beyond question.

Delanty vs. Yang Tsze Insurance Assn.
127 Wash. 238

> "We are of the opinion, however, that the dredging company did have an insurable interest in the boat by reason of the fact that it had possession of the boat and was at all events liable for the preservation or the value thereof to those whoever had legal right to it. Such possession gave rise to an implied promise on the part of the dredging company to restore the boat to its owner or owners, whoever they might be, though the

> lease contract be void for want of power in his surviving partners to execute it * * * * * We conclude that Tacoma Dredging Company had an insurable interest in the boat, and that the policy cannot be avoided for want of such interest in that company."

Counsel may contend that even though the insurance under this policy was in the first instance payable to the Montborne Lumber Company, yet the insurance, having been taken out upon property belonging to the railway company has an equitable lien thereon, entitling it to receive the proceeds of the insurance.

PAYMENT ON FIRE POLICY CAN ONLY BE TO NAMED ASSURED

The above, however, is not the law, in the absence at lease of any covenant in the lease requiring the lessee to take out such insurance, and there was in the contract at bar no such covenant.

A quiet elaborate note on this question is found in **66 A. L. R. 864**, and the general rule is there stated to be as follows:

> "It is quite generally held that, in the absence of an agreement to insure between the lessor and lessee, the proceeds of an insurance policy taken out by one of them or his privy cannot be claimed, in whole or in part, by the other, even though the policy covers the value of the interests of both in the property."

To the same effect is **Northern Trust Co. vs. Snyder, (1896), 22 C. C. A. 47, 46 U. S. App. 179, 76 Fed. 34:**

"A landlord may not recover from trustees to whom the lessees conveyed the estate the proceeds of an insurance policy on machinery and fixtures taken out by the lessees and made payable to the trustees, where there was no agreement obligating the lessees to effect insurance on the property for the benefit of the lessor."

And again, in **Lincoln Trust Co. vs. Nathan (1903) 155 Mo. 32, 74 S. W. 1007, it is held:**

"Where lessees insured themselves against loss in having to pay rent after the building was destroyed, and paid the premiums without any agreement with the lessors, the latter had no right to any of the proceeds of the policy."

To the same effect, also, is **Batts vs. Sullivan (1921) 182 N. C. 129, 108 S. E. 511:**

"A lessor cannot recover from his lessee one third of the proceeds of a policy of insurance taken out by the lessee at his own expense, without the knowledge of the lessor, to protect the lessee's interest in tobacco stored in the lessor's barn, of which the latter was entitled to one-third."

26 C. J. 436:

"In the absence of any contract between Landlord and tenant as to insurance by one for the benefit of the other, neither has any interest in insurance taken by the other in his own interest. But where the tenant stipulates to keep the premises insured for the benefit of the landlord, the latter is entitled to the proceeds of insurance taken by the tenant, and where the landlord takes out insurance as agent for the tenant, it belongs to the tenant."

8 Couch on Insurance, Sec. 1935, p. 6438:

> "As between the lessor and lessee of property which the lessee has insured against fire, the lessor has no claim to insurance money collected by the lessee, he having been under no obligation to insure for the benefit of the lessor and having paid for the insurance with his own money.
>
> The reason generally ascribed for the rule that a lessor or lessee, or his privy, cannot claim the benefit of insurance taken out by the other or his privy, unless there is an agreement in the lease to insure, is that the contract of insurance is a personal contract of indemnity which does not enure to the benefit of the other party."

FEATURES OF LIABILITY POLICY

It is true that the endorsement on the policy recites that the policy covers the **legal liability only** of the assured on the logging cars.

This is the only place in the policy where anything sounding in the nature of a policy of liability insurance appears.

While there might be some doubt, under ordinary circumstances, as to whether or not this would create a contract of liability insurance, yet it is to be remembered that this is a contract of insurance and as such is to be strictly construed against the insurance company and in favor of the assured. The Court's attention is respectfully called to the fact that the benefits of this rule of strict construction do not extend to what might be called third party beneficiaries or, as in this

case, the railroad company, but the policy is to be construed strictly against the insurance company and liberally in favor of the assured.

32 C. J. 1152:

> "It is a cardinal principle of insurance law that a policy or contract of insurance is to be construed liberally in favor of insured and strictly as against the company. Stated more fully, the rule is that, where, by reason of ambiguity in the language employed in a policy or contract of insurance, there is doubt or uncertainty as to its meaning and it is fairly susceptible of two interpretations, one favorable to insured and the other favorable to the company, the former will be adopted."

Thompson vs. American Brotherhood of Yeomen, 130 Wash. 179:

> "Contracts of this character which are indefinite as to their meaning, or subject to two constructions, will ordinarily be construed most strongly in favor of the assured and against the assurer. Remington vs. Fidelity Deposit Co., 27 Wash. 429, 67 Pac. 989; Algoe vs. Pacific Mutual Life Ins. Co., 91 Wash. 324, 157 Pac. 993; Mountain Timber Co. vs. Lumber Ins. Co., 99 Wash. 243, 169 Pac. 591."

To the same effect are Green vs. National Casualty Company, 87 Wash. 237, and Menger vs. Inland Empire Insurance Co., 118 Wash. 514.

Another reason why this policy can not be construed as a liability policy is because it contains none of the covenants usually and customarily contained in a liability policy.

Liability policies are of two kinds, either an indemnity contract or policy, or a liability contract or policy, and the distinction between these two classes of contract is well recognized.

36 C. J. 1057:

> "A policy of liability insurance, like ordinary contracts of indemnity, generally, is either a contract of insurance against loss or damage, and is called an 'indemnity contract' or an 'indemnity policy,' or it is a contract of insurance against liability for loss or damage, and is called a 'liability contract' or a 'liability policy.' Whether it is the one or the other depends upon the intention of the parties as evidenced by the phraseology of the agreement or covenant in the policy, and the determination of this intention is important in determining the accrual of the insurer's liability under the policy, there being a marked difference between a contract of insurance against loss and one against liability. If the policy contains conditions inconsistent with the theory of indemnity against damages, or otherwise clearly shows an intention to insure against liability for damages, it will be so construed, and is not merely a contract of indemnity against loss or damage by reason of liability. But where the policy plainly shows an intention only to pay the loss or damages for which insured was liable and has been compelled to pay, it is a contract of indemnity against loss or damage by reason of liability * * * Where the policy provides that insured shall immediately notify the company in case of accident or injury, that the company would defend actions growing out of injuries, in the name of insured, and that insured should not settle any claim or incur any expense without the consent of the company, it is generally held to be a policy of indemnity against liability for damages, and is not merely

> a contract of indemnity against damages. On the other hand, it has been held that a provision in the policy, that no action shall lie against insurer as respects any loss unless it is brought by insured himself to reimburse him for loss actually sustained and paid by him in satisfaction of a judgment, is a controlling factor in determining that the policy is one against loss or damage, and not against liability, although there are decisions to the effect that such a provision does not make the contract one of indemnity against damage where other provisions indicate indemnity against liability, particularly where the "no action" clause applies only in case the company denies liability and refuses to defend."

In this connection, the court's attention is respectfully called to the fact that there is no covenant in this contract regarding settlement by the assured, or anyone else, there is no covenant regarding indemnity, and there is no covenant regarding the defense of any asserted liability by a claimant against the assured.

A statement of the usual contents of liability policies is found in **36 C. J. 1110:**

> "Liability insurance policies, at the present time, whether liability policies or strict indemnity polcies, usually contain provisions to the effect that where suit is brought against insured for an injury covered by the policy, insurer, at its election may: (1) Defend the suit in the name and on behalf of insured, without any further assent or ratification from him, and without any interference by insured in the proceedings. (2) Settle the claim at its own cost. (3) Pay insured the stipulated amount of indemnity, leaving him to defend

himself against the claim as best he may."

There is in the policy before us neither covenant on behalf of the assured to defend the suit, settle the claim or covenant casting the burden of the defense upon the assured.

Another statement of the rule is found in **36 C. J. 1113:**

> "Under most, if not all, liability insurance policies, insurer reserves the right, at its election, to settle any claim against insured for loss or injury covered by the policy."

In the interpretation of the contract, effect, however, is to be given to all of the language contained therein, and it is respectfully submitted that the most liberal construction which can be given the language of the endorsement would regard it as a limitation of the extent of the liability of the company to the insured.

It is to be remembered that the contract between the lumber company and the railroad company was not made a part of this insurance contract and this limitation upon the amount for which the insurer might be liable was obviously placed in the contract to prevent the lumber company from realizing a profit upon the destruction of cars in its possession and belonging to others.

For example, suppose that the contract between the lumber company and the railroad company provided that in the event of the destruction by fire or otherwise of the cars belonging to the railroad company, that the loss should be borne equally. Under those circumstances, the endorsement on the policy would limit the liability of the insurance company to 50 per cent of the value of the destroyed property and would not permit the lumber company to collect the full value of the property from the insurance company when, in fact, the lumber company would be bound only to reimburse the railroad for 50 per cent of the loss.

Strength is given this contention by the use of the word "only" in the endorsement, for the endorsement reads that the policy covers the legal liability only of the lumber company in respect to these cars.

ONLY WAY LIABILITY ON FIRE POLICY DISCHARGED IS BY PAYMENT TO NAMED ASSURED

In the final analysis, the loss sustained under this policy was a loss by fire, even though the policy insured against other losses, tornado, cyclone, etc., and there is only one way in which a fire insurer may relieve itself of liability for a loss by fire, and that is by payment to the named assured and to no one else.

26 C. J. 434:

"As the policy is a personal contract between

> the insurer and the insured, and not a contract which in any sense runs with the property, the insurance money is generally payable to the person whose interest is covered by the policy, without regard to the nature and extent of his interest in the property, provided he had an insurable interest at the time of making the contract and also at the time of the loss; unless there is a stipulation to the contrary in the policy or unless he has assigned his right to the proceeds, or has by some misrepresentation or change of title or interest defeated his right to recover on the policy."

Another case which very definitely establishes this rule is the case of **Nelson vs. Nelson Neal Lumber Company, 171 Wash. 55.**

The facts in this case were that the Montborne Lumber Company was purchasing on real estate contract a sawmill and other property from the Nelson Neal Lumber Company, the contract of purchase requiring the Montborne Lumber Company to keep the property insured for the benefit of both the vendor and purchaser. Mr. Thomas Smith and Mr. James G. Smith, his son, were officers and trustees of both the Nelson Neal Lumber Company and the Montborne Lumber Company.

The insurance was taken out but the policy was payable to the Montborne Lumber Company only. A fire occurred, the mill was destroyed thereby, and the insurance company paid to the Montborne Lumber Company the face of the policy, $30,000.00.

The Montborne Lumber Company applied this $30,-000.00, acting throught its officers, Mr. Thomas Smith and Mr. James G. Smith, to other debts of the company, paid nothing there from to the Nelson Neal Lumber Company, and this suit was instituted by the stockholders of the Nelson Neal Lumber Company against Mr. Smith, his son, and other officers of the two corporations in conversion, and our supreme court held that the insurance money was properly paid to the Montborne Lumber Company, using the following language:

> "It is elementary that a fire insurance policy is a purely personal contract, and that payment by the insurer to the insured named in a policy is compulsory. Consequently, payment by the insurer to the Montborne Lumber Company was obligatory in order to acquit the insurer. It necessarily follows that receipt by the Montborne Lumber Company of the insurance proceeds was, in law, necessarily, a corporate act and not an act of the individuals sued herein. Wilcox vs. Gauntlett, 200 Mich. 272, 166 N. W. 856. Whatever may have been the liability of that corporation for conversion of the insurance fund, is not here at issue, for it is not sued."

CONCLUSION

In conclusion, it is respectfully submitted that the policy was a purely personal contract between the assured and the defendant and that payment by the defendant company to the receiver is compulsory, that that liability has not been discharged and that plain-

tiff should recover the amount of the damage sustained.

Respectfully submitted,

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